Ontario

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BACKGROUND

The imbalance in the revenues and expenditures of the different levels of government in Canada is well known to all participants at this national tri-level conference. Ontario's position on the fiscal imbalance between federal and provincial revenues has been stated many times. This paper therefore concentrates on the difficulties facing the local level of government.

Local government does not refer only to municipal governments. There are also a large number of autonomous local authorities in Ontario, the most important of which are school boards. Conferences such as this must consider the financing of local government together with the revenues and expenditures of these non-municipal local authorities.

The growth in local government expenditures in Canada during the past 20 years has been remarkable -- an increase of more than 800% in current dollars or more than 200% in constant-dollar-per-capita terms. The growth in expenditures has not been matched however by the growth of local levies.

Locally-raised revenues grew about 500% during the period 1952-1972, so that municipal spending was increasingly financed by transfers from the provinces and, to a far lesser extent, from the federal government. These transfers increased about 1800%, from 23% of total municipal revenues in 1952 to 48% in 1972.

The crux of the financing problem for local government is this. Local levies grow at 4-5% each year without rate increases while existing spending responsibilities grow at 10-12% per year.

The Province of Ontario is acutely aware of the financial predicament of the municipalities. In 1969 a major long-term program of reform of local government finances was set in motion. Under this program, provincial assistance to local government has been increased dramatically, 50% in the period 1970-1973 alone. These fiscal changes have not been carried out in isolation, but as part of an integrated plan which includes the restructuring of local government units in rapidly urbanizing areas, transfer of provincial powers to municipal councils, and up-grading of the skills of municipal administrators.

Proof of the Province's concern for the municipalities' financial dilemma is the fact that 35% of Ontario's total revenues in 1973 are being granted to local governments and to local ratepayers. This represents more than 90% of the total yield of the Province's two most important taxes -- the retail sales tax and the personal income tax. Assistance from Ontario accounted for 48.5% of the total revenues of the municipal level of government in 1973. Thus Ontario has evidenced its concern for local government needs with a major share of its revenues.

Ontario's Fiscal Transfers in 1973

	$ millions
Total Payments to Local Governments	1935
Payments to Special Purpose Agencies	260
Property Tax Credits	175
Farm Tax Rebates	35
Total Ontario Transfers	2405
Ontario's Total Revenues	6835
Ontario's Support as a Per Cent of its Total Revenues	35%

OUTLOOK FOR THE FUTURE

Material prepared for this conference, "Management for Growth", indicates that local government will experience future expansion of its activities and expenditures as large as in the past. While growth in such areas as education spending may be slower than in recent years, this decrease will be more than off-set by growth in expenditures to safeguard and improve the physical environment. It is in the areas of planning, housing, recreational facilities, transportation, and sewage facilities that municipalities will face the greatest challenges.

Ontario is confident that its municipalities are able to deal with the problems of urbanization, provided they have sufficient financial resources. But where is the money to come from? Despite massive infusions of provincial money in recent years, the local government sector still faces a growing deficit each year. At current levels of service, and after normal growth in existing provincial grant programs, the local sector deficit in Ontario is forecast as follows:

1974	$160 million
1975	$350 million
1976	$500 million

Local government must secure this additional financing to continue to provide the current level of existing services. Any new initiatives to deal with urbanization will require additional funding.

There are three ways to increase the amount of money available to local government:

1) increased municipal taxing -- i.e., increased use of the property tax

2) increased municipal borrowing

3) increased provincial transfers to local government.

Each of these three sources could generate new funds for local government, but not enough to cover forecast deficits, let alone enough to finance new municipal initiatives. Only a major financing reform such as revenue sharing by the federal government can generate the finances required by local government in the years ahead.

INCREASED USE OF THE PROPERTY TAX

The property tax has three major disadvantages: its extreme regressivity, its low yield, and its low rate of growth. As part of its ongoing reform of local government financing, the Province has acted to reduce property tax and thereby to minimize these disadvantages.

Ontario has reduced the regressivity of the property tax to some extent by means of property tax credits deductible from income tax. Using this method, relief from the burdens of property tax is directed towards those most in need of it: less prosperous families and elderly persons.

In addition to providing property tax credits, the Province makes rebates to farmers equal to half of their property taxes, which approximates all property taxes on farm lands. This measure was designed to reduce tax burdens on a section of the community which is severely affected by property taxes, and to encourage preservation of farm land. It is an example of Ontario's efforts to integrate its development strategy with reform of local government financing.

By reducing the regressivity of property tax burdens, the Province enables municipalities to make more use of property tax. The financial advantage of tax credits and rebates is therefore greater than the actual amounts expended by the Province in the transfers themselves. In the current fiscal year, Ontario's property tax credits will total $175 million and rebates of farm taxes will provide an additional $35 million in tax relief benefits.

In recent years, Ontario has increased payments in lieu of property taxes on its own properties substantially, thereby further increasing the capacity of the property tax. Additional measures announced in the 1973 Budget amounted to more than $8 million in payments on behalf of universities, hospitals, community colleges and penal institutions.

As accurate assessments are placed on different classes of exempt property, the removal of statutory exemptions in Ontario will speed up considerably, to the significant financial advantage of municipalities.

The capacity of the property tax may also be enlarged by increasing the proportion of the tax paid by the corporate sector. As a result of provincial action to keep mill rates down, realty and business taxes on commercial and industrial property have fallen from 1.9% of gross provincial product in 1970 to an estimated 1.6% in 1973. Ontario is at present investigating ways to shift property taxes from the residential sector, while at the same time safeguarding those enterprises which are unable to bear a higher rate of taxation.

An integral part of Ontario's reform of local finance was the provincial takeover of the assessment function in 1969. This marked the start of a complete reassessment of all realty within Ontario and will be completed by 1976. When all properties have been reassessed at market value, there will be reassessments at regular intervals so municipalities in Ontario can expect somewhat greater growth in their property tax bases in future years.

In addition to these reforms, Ontario has kept mill rate increases to a minimum by transferring funds from the Province to local governments. As a result, growth in net property taxes in the period 1970-1973 has been less than 5% while personal income rose 41% and gross provincial product rose 34%. Net property taxes as a percentage of gross provincial product therefore dropped from 4.1% in 1970 to an estimated 3.2% in 1973. Over the same period net residential and farm taxes fell from 2.9% to 1.9% of personal income.

In summary, Ontario has substantially alleviated many of the major problems of the property tax. But even with these improvements, the property tax cannot yield sufficient funds to cover local government's growing deficit without a return to the high mill rates of 1970. If municipalities were forced to raise mill rates unduly, this would negate much of the effort made since 1969 to increase the equity of the property tax and to improve the overall progressivity of the tax structure in Ontario.

MUNICIPAL BORROWING

While borrowing is hardly a satisfactory long run solution to the municipalities' financial predicament, scope does exist for more use of this type of financing. The total amounts raised by Ontario municipalities in the bond market have fallen during the past two years, while at the same time, capital expenditures financed out of current revenues have risen considerably. In future years, these trends could be reversed, so that more capital expenditure is financed by debentures.

To encourage municipalities to make greater use of their credit, Ontario is considering releasing some portion of the pension funds generated by the Ontario Municipal Employees Retirement Scheme. This would give municipalities access to a significant pool of internal capital funds, without recourse to the open market. It seems appropriate that some of the money generated by municipal employees should be used for the benefit of municipal financing.

Even with access to some OMERS funds, and with increased use of debentures, municipalities cannot expand their financial resources greatly by increased borrowing. Moreover, municipalities pay higher interest charges on their borrowing than do other levels of government. It is therefore in the best interests of the taxpayer, who must support federal, provincial and municipal governments, to ensure that borrowing be carried out by the senior levels of government as far as possible. From this viewpoint, it is unfortunate that municipalities should be forced to enlarge their borrowings at a time when the federal government is retiring substantial portions of its over-all debt.

INCREASED TRANSFERS FROM THE PROVINCE

There are two basic goals in Ontario's program of assistance to local government. The first,and more important, is that assistance shall be concentrated in those municipalities which have the greatest need of funds, coupled with inadequate property tax bases. The second is that our financial transfers shall be streamlined with conditional grants deconditionalized as far as possible.

Substantial progress has been made towards both goals. Some of Ontario's most important transfer programs -- e.g. education, and transportation -- already make payments to municipalities and school boards in inverse proportion to the property tax base available to each body. In addition, the grants to school boards take account of the expenditure needs of different school boards. On the municipal side, studies are in progress, with the co-operation of the municipalities, to develop an accurate method of quantifying the expenditure needs of municipalities.

In the 1973 Budget, the Property Tax Stabilization Program was introduced. The lynch pin of this $100 million program is unconditional grants to municipalities, inversely related to their property tax bases. In future years, it is anticipated that more and more of the Province's present grants will be merged into the Property Tax Stabilization Program. This will give municipalities greater flexibility in their spending, and will save both the Province and the municipalities administrative effort.

It is not realistic to expect all provincial grant programs to be merged into a single grant, however appealing this idea may be.

No single grant system could take into account the differing needs and resources of each of 900 municipalities, ranging in size from Metropolitan Toronto with more than 2 million inhabitants, to Cockburn Island with no permanent residents. Moreover, as long as part of local government services is provided by special purpose authorities, there will have to be specific grants to support the activities of these authorities.

Notwithstanding the above comments, any new Ontario assistance to the local sector will be unconditional as far as possible, in order to reinforce local budget autonomy and priority setting. Where incentive payments are indicated, the emphasis will be on "once only" payments rather than on continuing support. Programs which do give "on-going" support to municipalities will be reviewed periodically with a view to deconditionalization or simplification.

The above remarks on the future of provincial assistance to local governments have emphasized the need for rationalization and improvement of the present system of assistance, rather than out-lining new initiatives. This is deliberate because the Province of Ontario can no longer afford large increases in transfer payments each year.

In 1973, Ontario direct assistance to local government will total more than $1.9 billion. In addition $260 million will be paid to local agencies and $210 million will be returned to taxpayers in property tax credits and rebates. This direct and indirect assistance to local government therefore amounts to $2.4 billion, or about 35% of the Province's total revenues. But there is a limit to the Province's ability to raise its own taxes, and increase its own borrowing, in order to cover deficits at the local level. This limit is now being reached.

Latest estimates of provincial tax effort in Canada indicate that Ontario's overall tax effort has caught up to that of most other major provinces. Indeed, British Columbia, Alberta and Manitoba have a lower provincial tax effort than Ontario, while the tax efforts of Quebec, Saskatchewan and Nova Scotia are now only marginally higher than Ontario's. This means that the scope for increasing Ontario's taxes to enlarge grants to its local governments has been exhausted.

Ontario's own fiscal capacity is increasing at about 10% per year, in keeping with the growth of the economy. This growth rate enables Ontario to finance its own programs, but does not provide the capacity to cover increasing municipal deficits. In the period 1970-1973, assistance to local government grew 50%, while Ontario's total revenues increased 35%. The net result has been that the Province has increased the size of its own deficits to cover the local financial deficiency and prevent mill rate increases.

This method can be continued no longer. During the past four years, Ontario has carried a larger absolute deficit burden than the federal government, despite the latter's superior tax base and borrowing capacity. Resort to increased borrowing to cover provincial deficits cannot be continued indefinitely without substantial increases in the Province's borrowing costs.

In these circumstances, what further aid can Ontario offer the municipalities? Faced with a large deficit of its own, the Province cannot continue to increase grants to local governments faster than the growth of its own revenues. The most that can be offered is a growth rate of provincial assistance with equals the growth of Ontario's revenues.

<u>The Ontario Government, therefore, gives this guarantee to its local governments: provincial assistance in future years will grow at a rate not less than the growth rate of Ontario's total revenues</u>.

REVENUE SHARING AS A SOLUTION

Ontario municipalities face a growing deficit at current levels of service, combined with increasing pressure to expand the scope of the services they provide. Some funds to meet municipalities' needs could come from increased use of the property tax and increased resort to debenturing. Further improvement could be realized through the rationalization of provincial transfers to ensure that funds are concentrated in those municipalities where the need is greatest. These measures will assist municipalities but cannot remedy their basic financial problem of slow growing revenues with fast growing expenditures.

Ontario therefore joins its municipal partners to request the federal government to provide the funds to end the impending crisis at the local level of government.

In making this request, Ontario is fully aware that the Federal Government has its own expenditure priorities, and that the municipalities are the constitutional responsibility of the provinces. It is also aware that federal revenues are growing by 15% per annum, while municipalities' revenues, even with improved performance from the property tax, will not grow at much more than 5% per annum.

Provincial revenues have historically grown at around 11% per annum, but this will fall in future years because of Ottawa's unilateral decision to index personal income tax.

The federal government's surplus capacity has been well documented elsewhere, and this need not be repeated here, except for one quotation from the Public Accounts of Canada, 1971-72. The federal government auditors found that "the decade (1963-1972) covered a long period of almost uninterrupted economic expansion in which revenues rose at a faster rate than expendutures."

The crux of the matter is that the Federal Government has the money, while the municipalities have the needs. The fiscal imbalance between levels of government can therefore only be resolved by the transfer of tax capacity down to the local sector where the greatest financing needs arise.

There are two ways in which federal funds could be made available: either in direct grants to municipalities, or by increased tax sharing with the provinces, to be "passed through" to the municipalities.

Of these two forms of assistance from Ottawa, the Ontario Government rejects the first, and strongly urges increased income tax sharing for flow through to local governments.

Ontario hereby pledges to make available to local governments the full revenue benefits, dollar for dollar, of any new tax sharing made available by Ottawa. The Province will increase grants to the municipal level of government equal to 100% of any new tax sharing by the federal government.

It is understood, of course, that such an arrangement would have to be negotiated for a specified period of time, it being impossible to make an agreement in perpetuity. Moreover, such a fiscal redistribution would take the form of a transfer of tax capacity from the federal government to the Province rather than directly to the municipalities, with the Province assuming responsibility for the subsequent distribution of funds among the municipalities in consultation with the Municipal Liaison Committee.

Ontario rejects federal incentive grants as an alternative means to solving the financial dilemma of municipalities because such grants inevitably lead to increased municipal spending. Hence this approach could worsen, rather than improve, the local government financial outlook. Moreover, municipalities have indicated that incentive grants are the least acceptable form of assistance because they distort local priority setting and decision making.

CONCLUSION

To sum up the situation.

Local government faces growing demands for services, while its tax resources are insufficient to cover present levels of service. In Ontario, the Province has acted to enlarge the financial base of municipalities by improving the property tax and transferring provincial funds to local government. But Ontario cannot continue to finance a local sector deficit which is growing at a rate faster than the rate of growth of provincial revenues.

Attempts to do so during the past 4 years have forced Ontario to raise its tax rates substantially, and to increase its own annual cash deficit to the billion dollar level. But these actions are not sufficient to meet the problem of future burgeoning municipal deficits. The Ontario Government, therefore, calls on Ottawa to play its part in redressing the fiscal imbalance in Canada.

Ontario is prepared to continue assisting local government up to the limit of its financial capacity.

<u>To repeat</u>: (1) <u>Ontario's financial transfers to local government will grow at the rate of its total revenues</u>; (2) <u>municipal borrowing capabilities will be strengthened</u>; <u>and</u> (3) <u>increased federal tax sharing with Ontario will be delivered to local governments</u>, <u>dollar for dollar</u>.

This conference will never be looked back on as the time at which the financial problems of local government were solved. Local governments, like all governments, will have financial problems for as long as citizens demand more services, but resist more taxation. But if all three levels of government apply themselves to the problem of how to pay for the costs of urbanization, then this conference could mark the time that the financial outlook of Canadian municipalities moved from "critical" to "manageable".

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